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TITLE AND THE RIGHT TO POSSESSION UNDER THE UNIFORM COMMERCIAL CODE

HAL M. SMITH*

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INTRODUCTION

Official Comment 1 to Section 2-401 of the Uniform Commercial Code explains that the rules set forth in the section for determining when title passes "in no way alter the rights of either the buyer, seller or third parties declared elsewhere in the Article" The title rules are said to be stated "in case the courts deem any public regulation to incorporate the defined term of the 'private' law." Thus, the imposition of a sales tax, an income tax or a property tax may depend on the passage of title but not, according to the comment, the rights of buyer against seller or vice versa.

This article has a twofold purpose. First, it will attempt to set out the rights of a party to a sales transaction in obtaining possession of the goods where they are in the hands of the other party to the transaction, a carrier or other third party. Second, it will attempt to dispel the myth created by the comment that the Code has eliminated the concept of title as a method of determining rights and remedies of parties to a sales transaction. The article is organized for achievement of the first purpose. Within that organization, however, the concept of

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title will suggest itself repeatedly as the most available tool for solution of the problems that arise.

I. GOODS IN TRANSIT: POSSESSORY LIENS

Under the Uniform Sales Act, the buyer who has rejected goods, but still retained possession, had a lien to secure any part of the purchase price paid.¹ The Code provisions are similar.² Where the unpaid seller retained possession, but the property interest had passed to the buyer, the seller had under the U.S.A. a "right to retain [the goods] for the price."³ In case of the buyer's insolvency, the seller had the right to retain possession,⁴ or, if they had been shipped, to stop the goods in transit.⁵ The Code provisions again are similar.⁶ The unlimited right of a seller to reserve the right to possession by retaining title, despite delivery to the buyer, given by U.S.A. Section 20(1), was restricted by the U.C.C., however, and the seller now must file a financing statement to prevail against third parties.⁷

The buyer has the right to replevy goods identified to the contract "if the goods have been shipped under reservation, and satisfaction of the security interest in them has been made or tendered."⁸ A fortiori, the buyer must have the right to replevy goods which have been shipped without reservation.

While the goods are in transit under a non-negotiable bill of lading, even though title has passed, the seller has the power to regain possession or divert the shipment.⁹ The seller might divert the buyer's goods to a second purchaser, or a receiver in bankruptcy of the seller might recapture the goods. The clear implication from section 2-716(3) is that the buyer should prevail over both the second purchaser and over a lien creditor or trustee in bankruptcy of the seller.¹⁰ If the seller wrongfully regains possession of the goods and delivers them to a second buyer, it may be that the second buyer will lose even if he is a buyer in ordinary course within section 2-403(2). The first buyer has not "entrusted" his goods to the seller.

It can be argued that the buyer's right is limited by the term replevin, which imports a title right. However, the buyer's right to goods in transit may even extend to goods shipped under an FOB delivery

¹ Uniform Sales Act § 69(5) (act withdrawn 1962) [hereinafter cited as U.S.A.].

² U.C.C. § 2-711(3). Unless otherwise indicated all Uniform Commercial Code references are to the 1962 Official Text.

³ U.S.A. § 53(1)(2).

⁴ U.S.A. § 54(1)(c).

⁵ U.S.A. § 53(1)(b).

⁶ U.C.C. §§ 2-702(1), -703, -705.

⁷ U.C.C. §§ 1-201(37), 9-113, -301, -312.

⁸ U.C.C. § 2-716(3).

⁹ U.C.C. § 7-303(1)(b).

¹⁰ Cf. *Adkins v. Damron*, 324 S.W.2d 489 (Ky. 1959) (prior law).

point contract, where he would not have the title. Section 2-716(3) makes no distinction based on the shipping term, and in part at least allows replevin based on a special property interest rather than title. In a common trust receipt transaction, the financing agency may pay against a non-negotiable bill of lading and assume that it has a security interest in the goods because the buyer "has acquired rights in the collateral." If the buyer acquires no rights unless title to the goods has passed to him, then the financing agency would not have a security interest in goods in transit under an FOB delivery point contract, and an intervening lien creditor of the seller would prevail. Validation of trust receipt financing would thus supply one policy reason for giving the buyer rights in the goods in transit regardless of title. This argument, however, is probably adequately met by the argument that the financing agency can see that the buyer has title before it pays the price. A better answer is that a debtor-buyer's rights in goods by reason of identification to the contract are sufficient to support a security interest.

The seller's trustee in bankruptcy would have an additional argument that his right to reject executory contracts prevails over the buyer's state law right to possession.¹¹ Just what are executory contracts which the trustee in bankruptcy can reject is not clear, but the better view would be that if the bankrupt seller had fully performed and title has passed, the transaction is no longer executory within the purpose of Section 70b of the Bankruptcy Act to allow the trustee to reject burdensome property.

II. RIGHTS OF A SELLER NOT HAVING POSSESSION

Once the seller has parted with possession of the goods and has lost his right to stop in transit there are five possible theories under which he can establish a right to possession: (1) enforcement of a security interest; (2) common law replevin; (3) reclamation under section 2-507 if the sale is for cash; (4) common law rescission based on fraud; and (5) reclamation under section 2-702 if the buyer is insolvent. This section will examine each of these theories to establish the scope of the seller's right to obtain possession. Particular emphasis will be placed on the ability of the seller to enforce his right to possession against third party claimants.

A. *Security Interest*

If there is an agreement that the seller retain a security interest in the goods, this agreement is enforceable against the buyer. If the buyer should default on the security agreement, the seller can take possession of the goods.¹² If the security interest is perfected under

¹¹ Bankruptcy Act § 70b, 11 U.S.C. § 110(b) (1964).

¹² U.C.C. § 9-503.

Article 9,¹³ it can be enforced by the seller against subsequent lien creditors of the buyer¹⁴ or against subsequent good faith purchasers other than buyers in the ordinary course of business.¹⁵ Regardless, perfection of the security interest is not enforceable against a subsequent buyer in the ordinary course of business.¹⁶

B. *Replevin*

In order to maintain a common law replevin action for return of the goods, the seller must retain title.¹⁷ There are a number of types of transactions in which the seller might retain title. The first is the conditional sales transaction where the seller retains title as security for the payment of the price.¹⁸ The remaining two types of transactions, the sale or return and the sale on approval, share a common characteristic in addition to the seller's retention of title—the buyer may return the goods even though they conform to the contract for sale. In the sale or return, the seller puts the goods in the hands of the buyer so that he may resell them.¹⁹ In the sale on approval, the seller delivers the goods to the buyer primarily for use by the buyer.²⁰

The seller's right to possession in a transaction where title is retained for security is governed by section 2-401(1). This section provides that any retention by the seller of title in the goods shipped to the buyer is limited to a security interest.²¹ Therefore, at least as to this type of title reservation transaction, replevin against the buyer is not available to the seller as a theory distinguishable from enforcement of a security interest.

Although section 2-401(1) is also applicable to each of the other two categories, the effect of the section is circumscribed by the provisions of section 2-326. Under this section, goods held by a buyer "on approval" are not subject to the claims of the buyer's creditors until they are accepted by the buyer.²² As a result, a seller reclaiming the goods before acceptance would defeat the claim of a subsequent creditor of the buyer even though the creditor had no knowledge of any con-

¹³ The rules of perfection are contained in U.C.C. §§ 9-302, -305.

¹⁴ See U.C.C. §§ 9-201, -302(1)(b).

¹⁵ See U.C.C. §§ 9-201, -301(1)(c). There is one exception to this rule. A buyer of consumer goods or farm equipment worth less than \$2500 takes free of a perfected security interest if he buys "for his own personal, family or household purposes or his own farming operations" without knowledge of the security interest unless the secured party has filed. U.C.C. § 9-307(2).

¹⁶ U.C.C. § 9-307(1).

¹⁷ See *Hannibal Inv. Co. v. Schmidt*, 113 S.W.2d 1048 (Mo. App. 1938).

¹⁸ See Uniform Conditional Sales Act § 1 (act withdrawn 1943).

¹⁹ U.C.C. § 2-326(1)(b).

²⁰ U.C.C. § 2-326(1)(a).

²¹ See also U.C.C. § 1-201(37). But cf. *San Diego Wholesale Credit Men's Ass'n v. Garner*, 325 F.2d 862 (9th Cir. 1963).

²² U.C.C. § 2-326(2).

flicting claims in the goods. The seller, however, would not be able to obtain possession from a subsequent purchaser of the goods. The sale by the buyer would constitute an acceptance and, therefore, the seller would have to enforce any rights he might have against the buyer. A more difficult situation arises if the resale by the buyer is made after a rightful demand by the seller for return of the goods. Even in that situation, however, it is doubtful that the seller can exercise his right against the purchaser. Since section 2-326 does not provide for seller's rights against subsequent purchasers, these rights would be governed by the section 2-401(1) provision that retention of title is limited to a security interest. This interest can be enforced against the purchaser only if the seller takes the steps to perfect under Article 9.

Under section 2-326, the "sale or return" is treated very nearly as it would be if section 2-401(1) alone were determinative. Section 2-326 expressly provides that the goods are subject to the claims of the buyer's creditors once they are in the hands of the buyer.²³ Therefore, the seller's right to replevin can always be defeated by a lien creditor.²⁴ In addition, it is clear that, as in the "sale on approval," the seller cannot exercise replevin against the subsequent purchasers.

C. *Reclamation Under Section 2-507*

Under section 2-507, when delivery of goods or documents of title is made and payment is due, the buyer's right to retain or dispose of the goods is conditioned upon his making that payment. Thus, when the delivery is conditional on payment in cash and the cash is not paid, the seller should be able to reclaim the goods. Since section 2-511(3) provides that "payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment," the seller should also be able to reclaim if he is paid with a check that is later dishonored.

Section 2-507 defines only the rights of the seller against the buyer. Since the section does not mention the seller's rights against other claimants, such as a good faith purchaser or attaching creditor, it may be read that the seller has no rights against these claimants. Another section of the Code shows that this interpretation of 2-507 reaches the proper result with respect to a subsequent good faith purchaser, even

²³ Id. It has been held that section 2-326(2) does not apply in "bona fide consignment" transactions. *In re Mincow Bag Co.*, 53 Misc. 2d 599, 279 N.Y.S.2d 306 (Sup. Ct. 1967).

²⁴ See U.C.C. § 2-326(3) which deals with consignment transactions. It provides that where goods are delivered to a person for sale and that person maintains a place of business where he deals in goods of the kind involved, then the goods are deemed to be on sale or return with respect to the creditors of the person receiving the goods. This rule applies even if the goods are delivered to an agent who is a dealer of goods of the kind involved. *General Elec. Co. v. Pettingell Supply Co.*, 347 Mass. 631, 199 N.E.2d 326 (1964).

though the buyer received delivery in a cash sale or in exchange for a check that was later dishonored.²⁵

Reading into the silence of 2-507 an intent to subordinate the seller's reclamation right to the rights of subsequent claimants is more difficult when the subsequent claimant is a lien creditor. Prior to the Code, creditors have usually been given no greater rights than their debtors.²⁶ If this policy is read in section 2-507, the rights given the seller against the buyer are also enforceable against the lien creditor. One court has adopted this approach and found that a seller could reclaim under 2-507 and cut off the interest of the lien creditor.²⁷

D. *Reclamation Under Section 2-702*

Section 2-702(3) provides:

The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this Article (Section 2-403). Successful reclamation of goods excludes all other remedies with respect to them.

The rights of the seller against the buyer as defined by section 2-702(2) are clear from the section. With less clarity, however, section 2-702(3) attempts to define, at least in part, the relationship of these reclamation rights to third party claimants. The 1966 version of 2-702(3) provides that "the seller's right to reclaim under subsection (2) is subject to rights of a buyer in the ordinary course or other good faith purchaser under this article (section 2-403)." This subsection will analyze in depth the seller's right to reclaim against subsequent purchasers and lien creditors with emphasis on a claimant that presents unique problems, the trustee in bankruptcy.²⁸

A subsequent buyer in ordinary course or other good faith purchaser can defeat a seller's attempt to reclaim only if he can establish a right to possession under Article 2 that conflicts with the seller's reclamation right. Section 2-702(3) refers to section 2-403 for the rights of the good faith purchaser. Section 2-403 provides: "A person with voidable title has power to transfer a good title to a good faith purchaser for value." In treating transactions between a buyer and his subsequent purchaser, it goes on to provide that "[w]hen goods have been delivered under a transaction of purchase" the original buyer has

²⁵ U.C.C. § 2-403(1)(b), (c).

²⁶ See 1 G. Glenn, *Fraudulent Conveyances and Preferences* § 19, at 36-37 (rev. ed. 1940) [hereinafter cited as Glenn].

²⁷ See *In re Mort Co.*, 208 F. Supp. 309 (E.D. Pa. 1962). But see Shanker, *A Reply to the Proposed Amendment of U.C.C. Section 2-702(3): Another View of Lien Creditor's Rights vs. Rights of a Seller to an Insolvent*, 14 W. Res. L. Rev. 93 (1962).

²⁸ Other claimants such as a repairman or the Internal Revenue Service could arise, but their relative rights will not be discussed.

the power to transfer even though he acquired such title through certain enumerated fraudulent practices.

It is clear that where the buyer receives goods on credit while insolvent he acquires title voidable by the seller's 2-702 reclamation right. Therefore, under section 2-403, the buyer has power to transfer good title to the subsequent good faith purchaser for value. As between a buyer and a subsequent purchaser from him, however, section 2-403 goes on to give the power to transfer good title to the buyer only when there has been a delivery of the goods to the original buyer. The use of the term "delivery" suggests that the buyer must have possession in addition to title to transfer good title to a subsequent good faith purchaser.

The term "delivery" is not defined in the Code, but section 2-503(1) provides that "tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery." Delivery is also normally determinative of passage of title under section 2-401: "Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest" Although both sections 2-403(1) and 2-401 imply that the buyer must somehow take possession for delivery to occur, it is not clear that this concept of delivery was intended in section 2-403. Section 2-401 is a title section. It provides that, absent a contrary agreement, title passes on tender of delivery. It is possible that in some cases, for example where seller's delivery occurs at his place of business, the buyer will get title without possession under section 2-401. Since section 2-403(1) also provides rules for passage of title, it is probable that "delivery" as used in 2-403 is identical to tender of delivery under 2-401. Under this interpretation the presence of the wording "when goods have been delivered under a transaction of purchase" can be explained as a reference to when the buyer obtains the title that he is attempting to transfer.

If the above analysis is accepted, the buyer has the power to transfer title to the goods to a subsequent good faith purchaser and, thus, cut off the seller's reclamation right even though the seller retains possession. This situation, where delivery occurs without the seller's losing possession, would, of course, be rare. Also the seller would still have some protection since he would retain a superior claim for the price, which the second buyer would have to satisfy before he could recover the goods. If the goods were in transit at the time the buyer transferred to the subsequent purchaser, however, the seller would lose this right to the price once the goods are received by the buyer or subsequent purchaser.

The lack of clarity in section 2-403 as to whether the buyer must have possession to defeat the reclaiming seller is also present with respect to the subsequent good faith purchaser. Section 2-403 gives the buyer the power to transfer title to the subsequent good faith purchaser, but neither section 2-403 nor 2-702 provides that title in the subsequent good faith purchaser alone will defeat the seller's right to reclaim. This ambiguity can be resolved by examination of the prior law.

Under Section 24 of the Uniform Sales Act, when the seller of goods has voidable title and this title is not avoided before sale of the goods, a good faith purchaser for value acquires good title. This section has been uniformly interpreted as giving the subsequent purchaser the right to defeat a rescission by the original seller, even though the subsequent purchaser did not have possession, unless the original seller rescinded before the subsequent purchaser obtained title.²⁹ The wording of Section 2-403 of the Code is sufficiently similar so that it should be interpreted in the same manner.³⁰ This interpretation is supported also by the definition of purchase in section 1-201(32). Under this section, purchase includes taking an interest in property by mortgage or lien. In these transactions a third party obtains an interest in property, but he does not obtain possession.³¹ Therefore, since possession is not necessary to a "purchase" under 1-201(32), it should not be necessary to a "purchase" under 2-403.

There is additional ambiguity in the prerequisites to defeat of the reclaiming seller by the subsequent purchaser. It is clear that the subsequent purchaser must give value. Both the Sales Act and the Code include within the definition of value the satisfaction of a prior debt or claim.³² Under the Sales Act, however, the courts continued to follow

²⁹ The cases under this section held that the subsequent buyer's right to defeat the rescinding seller depended on the buyer's having technical title. See *Pingleton v. Shepherd*, 219 Ark. 473, 242 S.W.2d 971 (1951); *Keegan v. Kaufman Bros.*, 68 Cal. App. 2d 197, 156 P.2d 261 (1945); *Woonsocket Rubber Co. v. Loewenburg*, 17 Wash. 29, 48 P. 785 (1897). In addition, in instances where the subsequent buyer had possession without title, he could prevail over the rescinding seller if he could show that the seller was estopped from denying his title. See, e.g., *Handey Motor Co. v. Wood*, 238 N.C. 468, 78 S.E.2d 391 (1953); *Keegan v. Lenzie*, 171 Ore. 194, 135 P.2d 717 (1943). One line of these estoppel cases dealt with entrusting goods to a merchant. See, e.g., *Meadows v. Hampton Live Stock Comm. Co.*, 55 Cal. App. 2d 634, 131 P.2d 591 (1942). The Code adopted the rule of this line of cases in section 2-403(2). It may also be interpreted as adopting the rule of all of these estoppel cases since the law of estoppel is not displaced by the Code. U.C.C. § 1-103.

³⁰ See *Metropolitan Distribs. v. Eastern Supply Co.*, 21 Pa. D. & C.2d 128 (C.P. 1959). But cf. *Hudiberg Chevrolet, Inc. v. Ponce*, 17 Wis. 2d 281, 116 N.W.2d 252 (1962) where the court held that a good faith purchaser won despite the original seller's prior attempts to rescind or reclaim on the ground that the check which the seller received from the buyer did not clear.

³¹ If the subsequent purchaser is a secured party, there does not even seem to be the requirement that he perfect his security interest under Article 9. Cf. *Main Inv. Co. v. Gisolfi*, 203 Pa. Super. 244, 199 A.2d 535 (1964).

³² U.S.A. § 76; U.C.C. § 1-201(44).

the common law rule that a seller's right to rescind could not be cut off by a sale in consideration for release of an antecedent indebtedness despite the Act's contrary definition.³³ The common law rule might be continued under the Code even though the Code has a contrary definition of "value" on the theory that the context of section 2-403 is akin to estoppel and the section 1-201 definition of "value" is not applicable. Acceptance of such a theory would have ramifications beyond the prior indebtedness question. At common law a purchaser who has only promised to pay could not be a good faith purchaser.³⁴ Under the Code's definition of value, the credit purchaser can be a good faith purchaser for value.³⁵ If this definition of value does not apply to section 2-403, however, the common law rule might still be the law.³⁶

From the above analysis, the rights of the reclaiming seller against a subsequent purchaser can be seen to turn almost exclusively on title. Once the original buyer obtains title, he has the power by transfer to a subsequent good faith purchaser to cut off the seller's reclamation right. Likewise, once the subsequent good faith purchaser obtains title, he may cut off the seller's rights. This passage of title from seller to buyer to subsequent purchaser may, in fact, occur without the seller ever losing possession of the goods.

Under the 1966 version of section 2-702, the rights of a reclaiming seller against a subsequent lien creditor are easily defined. Section 2-702(3) expressly states that "the seller's right is subject to the rights of a buyer in ordinary course or other good faith purchaser" under Article 2. Section 2-702(3) does not subject the seller's reclamation right to the rights of a lien creditor. This omission might be ambiguous but for the statutory history and comments which make it clear that the omission of the lien creditor in 2-702(3) is intended to mean that the lien creditor cannot defeat the rights of the reclaiming seller.³⁷

Because only California has adopted the 1966 version of 2-702(3),³⁸ it is necessary to consider the earlier version of the Code for

³³ See *Smith v. Autocar Sales & Serv. Co.*, 107 Ind. App. 244, 20 N.E.2d 188 (1939); *Automobile Equip. Co. v. Motor Bankers Corp.*, 251 Mich. 220, 231 N.W. 559 (1930). See generally Annot., 44 A.L.R. 488 (1926).

³⁴ See, e.g., *Schloss v. Feltus*, 96 Mich. 619, 55 N.W. 1010 (1893).

³⁵ U.C.C. § 1-201(44).

³⁶ See G. G. Bogert & G. T. Bogert, *Trusts & Trustees*, § 887 at 154 (2d ed. 1960), [hereinafter cited as *Bogert*], in which it is assumed that the common law definition of value is inapplicable under the Code.

³⁷ See Report No. 3 of the Permanent Editorial Board for the Uniform Commercial Code 3 (1966).

³⁸ Cal. Comm. Code § 2701(3) (West 1964). In addition, twelve states have deleted the words "or lien creditor" from section 2-702(3). See Ark. Stat. Ann. § 85-2-702(3) (Cum. Pocket Part 1967); Conn. Gen. Stat. Ann. § 42a-2-702(3) (Cum. Pocket Part 1968); Ill. Ann. Stat. ch. 26 § 2-702(3) (Smith-Hurd 1963); Kans. Stat. Ann. § 84-2-702 (Cum. Pocket Part 1967); Me. Rev. Stat. Ann. tit. 11, § 2-702(3) (1964); N.J. Stat. Ann. § 12A: 2-702(3) (Cum. Pocket Part 1967); N.M. Stat. Ann. § 50A-2-702(3) (1962);

a complete analysis of the seller's reclamation rights against lien creditors. The earlier version of 2-702(3) stated that the seller's reclamation right was subject to the rights of a lien creditor under Article 2. Unfortunately the term "lien creditor" is not defined either in Article 2 or Article 1. In addition, there is no provision in the Code stating what the rights of a lien creditor are under Article 2.

Although the term "lien creditor" is not defined in Articles 2 or 1, it is defined in section 9-301 as including a creditor who has obtained a lien by attachment or levy, an assignee for the benefit of creditors, and a trustee in bankruptcy. It is generally assumed that this definition may be used for purposes of section 2-702. Although such a conclusion is not mandatory, since the use of the definition does not conflict with any section or policy of Article 2, it would appear to be both necessary and proper to use it.

There are a number of possible interpretations of the words "rights of a lien creditor" under Article 2. Professor Shanker³⁹ has argued that the rights of lien creditors under Article 2 can be found in section 2-326(3):

(3) Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return.

Under subsection (2), when goods are held by the buyer on sale or return they are subject to the claims of the buyer's creditors. Taken literally and without regard to the context, therefore, section 2-326(3) gives certain rights to lien creditors.

It is a long step, however, to say that because section 2-326 gives rights to lien creditors these are the rights that are stated in section 2-702. Section 2-326 deals with certain types of title reservation transactions. The second sentence of subsection (3) states: "The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as 'on consignment' or 'on memorandum'." Viewed in this context, the intent of subsection (3) is most likely to treat goods held by a buyer without title on the same footing as goods held with title in some situations. That is, the creditor of the buyer can reach these goods regardless of the seller's title. Because of its limited appli-

N.Y. U.C.C. § 2-702(3) (McKinney 1964); N.C. Gen. Stat. § 25-2-702(3) (Cum. Pocket Part 1967); N.D. Cent. Code § 41-02-81-3 (1968); Tex. Bus. and Comm. Code Ann. § 2.702(c) (1968); Wyo. Stat. Ann. § 34-702(3) (Cum. Pocket Part 1967).

³⁹ Shanker, *supra* note 27.

cation, it is unlikely that this provision was intended to displace seller's rights to reclaim under section 2-702. This limited interpretation of section 2-326(3) is supported by the comment to the section, which states subsection (3) "resolves all reasonable doubts *as to the nature of the transaction* in favor of the general creditors of the buyer."⁴⁰ (Emphasis added.)

Another possible interpretation of the rights of a lien creditor under Article 2 is that they are the same as the rights of the lien creditor under Article 9. This argument is supported by the reference in section 2-702(3) to section 2-403. Section 2-403 states that the rights of lien creditors "are governed by the Article on Secured Transactions (Article 9)." Since under section 9-301 lien creditors have priority over unperfected security interests, the result of this argument is to subject the reclaiming seller to the claims of creditors if the seller's reclamation right is an unperfected security interest. If the right to reclaim is a security interest, it would have to be filed to be perfected.

Adopting the Article 9 provisions on the rights of lien creditors raises both conceptual and practical difficulties. "Security interest" is defined in section 1-207(37) as an "interest in personal property or fixtures which secures payment or performance of an obligation." Only if the meaning of securing "performance of an obligation" is stretched, can a reclamation right be found to be a security interest.⁴¹ Even if the right to reclaim can be made to fit within the 1-201(37) definition, however, the whole context of Article 9 inclines against such a fit. Security interests under Article 9 are the result of consensual transactions,⁴² whereas the right to reclaim is created without the parties ever intending to create a property interest. Also, as a practical matter, since under section 9-113 security interests arising under Article 2 must be filed if the debtor has possession of the goods, characterization of the right to reclaim as a security interest will mean that the seller will always lose to a subsequent lien creditor. The seller will never have the requisite signed financing statement nor will he have time to file.

Since section 2-702(3) mentions rights of a lien creditor but nowhere defines them, it is possible to interpret the section as giving the lien creditor the right to defeat the reclaiming seller in all instances. Such an interpretation, however, would nullify section 2-702(2) without expressly stating so and, therefore, seems to be invalid.

The only case to treat the ambiguities of section 2-702(3) in regard to the lien creditor adopted an approach different from any of the above. In *In re Kravitz*,⁴³ the Third Circuit Court of Appeals held that

⁴⁰ U.C.C. § 2-326, Comment 2.

⁴¹ Conceptually, the only way to find that the section 1-201(37) definition applies is to picture the obligation of the buyer as secured by the seller's right to reclaim.

⁴² See U.C.C. §§ 9-201, -204.

⁴³ 278 F.2d 820 (3d Cir. 1960).

since prior Pennsylvania law gave superior rights to lien creditors whose claims arose subsequent to the debtor's acquisition of the goods, the seller's right to reclaim would be defeated by such a creditor. The court apparently would draw a distinction between prior and subsequent creditors and hold the former's interest is cut off by the reclaiming seller whereas the latter's is not cut off. This distinction has been recognized at common law in a number of jurisdictions on the basis that the subsequent creditor has relied on the debtor's ownership of the goods whereas the prior creditor has not.⁴⁴ There does not appear, however, to be any room for such a distinction in section 2-702(3). The section gives rights to lien creditors but does not distinguish between prior and subsequent creditors.⁴⁵ It is possible, of course, that the creditor could show justified reliance sufficient to set up an estoppel against the seller. In this situation, however, the Code rules could be supplemented by the common law estoppel principles to give the creditor a remedy.

The better interpretation of the original version of section 2-702(3) is that made mandatory by the 1966 version, which provides that since Article 2 does not provide for rights of lien creditors, the reclaiming seller can defeat the interest of a lien creditor. In those cases where the creditor can show actual reliance he may defeat the seller's reclamation right if he can establish an estoppel against the seller under the common law.

Before the 1966 amendment to section 2-702(3), the ambiguities in the section in regard to lien creditors also raised doubt on the ability of the reclaiming seller to defeat the claims of the trustee in bankruptcy. Under Section 70c of the Bankruptcy Act, the trustee is vested with all the rights of a lien creditor, whether or not such a creditor could have obtained a lien by legal or equitable proceedings on the date of the filing of the bankruptcy proceeding. In *Kravitz*, the court inter-

⁴⁴ See *Schwartz v. McCloskey*, 156 Pa. 258, 27 A. 300 (1893), (the case on which the court in *Kravitz* relied); *Thompson v. Rose*, 16 Conn. 71 (1844); *Hurd v. Bickford*, 85 Me. 217, 27 A. 107 (1892); *McAuliffe & Burke Co. v. Gallagher*, 258 Mass. 215, 154 N.E. 755 (1927); *Buffington v. Gerrish*, 15 Mass. 156 (1818); *Bradley v. Obear*, 10 N.H. 447 (1839). The *Buffington* case was followed without discussion of the prior-subsequent creditor distinction in *Oswego Starch Factory v. Lendrum*, 57 Iowa 573, 10 N.W. 900 (1881); *Sleeper v. Davis*, 64 N.H. 59, 6 A. 201 (1886); *Root v. French*, 13 Wend. 570 (N.Y. 1835); *Scott v. McGraw*, 3 Wash. 675, 29 P. 260 (1892). For a case involving subsequent creditors in which the court said all bona fide purchasers prevail, see *Van Duzor v. Allen*, 90 Ill. 499 (1878); but see *Schweizer v. Tracy*, 76 Ill. 345 (1875). The *Van Duzor* case was distinguished in *In re Gold*, 210 F. 410 (7th Cir. 1913). Perhaps the only express holding contra is *Field, Morris & Co. v. Stearns*, 42 Vt. 106 (1869). It is generally assumed, however, that the majority view is correct. See Kennedy, *The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 14 Rutgers L. Rev. 518, 550 (1960); Nordstrom, *Restitution on Default and Article Two of the Uniform Commercial Code*, 19 Vand. L. Rev. 1143, 1159 n.68 (1966).

⁴⁵ Prior and subsequent creditors have the same rights under sections 2-326 and 9-301. They apparently have the same rights under section 6-104.

preted section 70c as providing that the trustee in bankruptcy could defeat the rights of a reclaiming seller, if it were possible that a creditor could defeat those rights.⁴⁶ Therefore, the rights of the trustee turn on the rights of creditors under section 2-702, whatever they may be. Since the court in *Kravitz* found that it was possible for a creditor to defeat the rights of the reclaiming seller, it found that the seller's claim was invalid against the trustee. Under the 1966 amendment to section 2-702, it is clear that the trustee will not defeat the reclaiming seller under section 70c.⁴⁷

The trustee, however, has available another theory of attack under the Bankruptcy Act. Section 64 of the Act establishes a general order of priorities for claims against the assets of the bankrupt. State statutes that attempt to set up a different order of priorities are, of course, preempted by the Federal Act.⁴⁸ Exactly when a state's statute attempts to set up priorities in bankruptcy, however, is not always easy to determine. A statute that provides for a lien in favor of a particular type of creditor, e.g., mechanics, affects the priority of distribution to that creditor in bankruptcy since a lien creditor takes from the assets before a general creditor. Since the statute operates whether or not the debtor is in bankruptcy, however, it is not an attempt to set up an order of priorities in bankruptcy but, instead, to put this type of creditor in a preferred position relative to other creditors irrespective of the financial condition of the debtor.⁴⁹ On the other hand, where the state statute did not denominate the right as a lien,⁵⁰ where it did not provide that the lien was enforceable as against any subsequent lienors,⁵¹ where it provided that the lien arose only upon execution against the property by another creditor,⁵² or where it did not provide that the lien was on

⁴⁶ The court in *Kravitz* found that the trustee could prevail regardless of whether a creditor who could defeat the seller actually existed. The decision of the Supreme Court in *Lewis v. National Bank*, 364 U.S. 603 (1961), may now require a showing that some actual subsequent creditor existed at the time of bankruptcy. See *Pacific Fin. Corp. v. Edwards*, 304 F.2d 224 (9th Cir. 1962); Note, 76 Harv. L. Rev. 1296 (1963). Since the *Lewis* and *Edwards* decisions, section 70c has been amended. 80 Stat. 268 (1966). Although the third sentence of the amended 70c can be read as supporting the view that the presence of an actual subsequent creditor must be shown, the legislative history does not indicate such an intent. See S. Rep. No. 1159, 89th Cong., 1st Sess., 1966 U.S. Code Cong. & Ad. News 2456.

⁴⁷ There also is considerable authority indicating that this would be the result even if the Code had not been amended. See 4A W. Collier, Bankruptcy ¶ 70.41 at 483 n.3, 485 n.7 (14th ed. 1967); Annot., 59 A.L.R. 418 (1929).

⁴⁸ *N.W. Day Supply Co. v. Valenti*, 343 F.2d 756 (1st Cir. 1965).

⁴⁹ See 3 W. Collier, Bankruptcy ¶ 64.02[2] (14th ed. 1967).

⁵⁰ *In re Crosstown Motors, Inc.*, 272 F.2d 224 (7th Cir. 1959); *Strom v. Peikes*, 123 F.2d 1003 (2d Cir. 1941).

⁵¹ *N.W. Day Supply Co. v. Valenti*, 343 F.2d 756 (1st Cir. 1965); *In re Ko-Ed Tavern, Inc.*, 129 F.2d 806 (3d Cir. 1942).

⁵² *In re Beardsley*, 38 F. Supp. 799 (D. Md. 1941); *In re Standard Wood Prods. Co.*, 38 F. Supp. 20 (M.D. Pa. 1941).

specific property,⁵³ courts have found that the state has attempted to create priorities in bankruptcy and, therefore, that the liens are invalid as against the trustee.

Whether section 2-702, granting the seller the right to reclaim on the insolvency of the buyer, would be declared as an attempt to create a priority invalid under the Bankruptcy Act is an open question. In any event, under the 1966 amendments to the Bankruptcy Act, that question must now be answered by construction of section 67c,⁵⁴ since the priority principle, to the extent it is recognized, is now codified in that section.⁵⁵

Section 67c of the Bankruptcy Act now provides:

- (1) the following liens shall be invalid against the trustee:
 - (A) every statutory lien which first becomes effective upon the insolvency of the debtor, or upon distribution or liquidation of his property, or upon execution against his property levied at the instance of one other than the lienor;
 - (B) every statutory lien which is not perfected or enforceable at the date of bankruptcy against one acquiring the rights of a bona fide purchaser from the debtor on that date, whether or not such purchaser exists: *Provided*, That where a statutory lien is not invalid at the date of bankruptcy against the trustee under subdivision (c) of section 110 of this title and is required by applicable lien law to be perfected in order to be valid against a subsequent bona fide purchaser, such a lien may nevertheless be valid under this subdivision if perfected within the time permitted by and in accordance with the requirements of such law. . . .⁵⁶

Section 1(29a)⁵⁷ defines "statutory lien" as "a lien arising solely by force of statute upon specified circumstances or conditions, but shall not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is made fully effective by statute." It is clear that if the seller's right to reclaim is a statutory lien, it is invalid as against the trustee under 67c(1)(B) since it is not enforceable against one acquiring the rights

⁵³ *Strom v. Peikes*, 123 F.2d 1003 (2d Cir. 1941). Cf. *Elliott v. Bumb*, 356 F.2d 749 (9th Cir. 1966).

⁵⁴ 11 U.S.C. § 107c (Supp. II 1966), amending 11 U.S.C. § 107c (1964).

⁵⁵ See S. Rep. No. 1159, 89th Cong., 1st Sess., 1966 U.S. Code Cong. & Ad. News 2456, 2457.

⁵⁶ 11 U.S.C. § 107(c) (Supp. II 1966).

⁵⁷ 11 U.S.C. § 1(29a) (Supp. II 1966).

of a bona fide purchaser from the debtor on the date of bankruptcy. Thus, the central question is whether the reclamation right is a statutory lien within the definition in section 1 (29a). There are two possible answers that will result in upholding section 2-702 against the trustee: (1) the right to reclaim is not a lien; (2) the right to reclaim is not "statutory" since it does not arise "solely by force of statute."

There should be no doubt that the seller's right to reclaim is a lien, at least up to the point that he asserts his right and regains technical title. It is a claim on specified property arising out of an underlying debt.⁵⁸ Prior cases invalidating state statutory rights because they were not called "liens" were justifiable only as attempts to distinguish between valid state liens and invalid, state-created priorities where Congress had failed to provide definitions of these terms. Now that Congress has specifically defined statutory lien and indicated when it should be treated as a priority, the state denomination of the right should not be important. Further, it would be consonant with the purpose of the Bankruptcy Act to hold that the seller has a lien even after he regains title since he does not have possession. In that case, however, since a good faith purchaser cannot defeat the seller's interest after he regains title, the seller's right is enforceable against the trustee. Since the reclamation right is a lien, the validity of that lien against the trustee must turn on whether it is "statutory," that is, whether it arises solely by force of statute.

Although the term "statutory lien" never had a specific statutory definition, it has always been a part of the bankruptcy law. For the most part, however, the cases that turn on a determination of whether a particular right is a statutory lien are of little help in assessing section 2-702. Courts have found that consensual liens are not statutory liens.⁵⁹ On the other hand, they have found tax liens and mechanic's liens to be statutory, since they clearly arise solely by force of statute.⁶⁰ Between these two extremes, however, the law is somewhat unclear. For example, a vendor's lien has been found to be statutory even though it is, at least in part, consensual.⁶¹

⁵⁸ See *In re New Haven Clock & Watch Co.*, 253 F.2d 577 (2d Cir. 1958); *Lockhart v. Garden City Bank & Trust Co.*, 116 F.2d 658 (2d Cir. 1940); *United States v. First Nat'l Bank*, 240 F. Supp. 347 (N.D. Tex. 1965); *In re Tele-Tone Radio Corp.*, 133 F. Supp. 739 (D.N.J. 1955). But see *White v. Karl Kiefer Mach. Co.*, 127 F.2d 119 (8th Cir. 1942).

⁵⁹ Cases cited note 57 *supra*.

⁶⁰ See *In re Rhine*, 213 F. Supp. 527 (D. Colo. 1963) (mechanics' lien). Section 67b provides that tax liens are statutory liens. 11 U.S.C. § 107(b) (Supp. II 1966).

⁶¹ See *Commercial Credit Co. v. Davidson*, 112 F.2d 54 (5th Cir. 1940). See also *In re Standard Wholesale Grocers, Inc.*, 174 F.2d 594 (2d Cir. 1949) (Sheriff's lien for fees from an execution); *Halpert v. Industrial Comm'r*, 147 F.2d 375 (2d Cir. 1945) (lien for a workmen's compensation award); *Lyford v. New York*, 140 F.2d 840 (2d Cir. 1944) (lien for the cost of eliminating a grade crossing); *Reconstruction Fin. Corp. v. Sun*

The seller's right to reclaim is clearly neither a vendor's lien nor a consensual lien. It has one important attribute, however, that would seem to take it out of the class in which vendor's liens, tax liens, etc. are placed. Tax liens or even vendor's liens have no common law antecedents. In contrast, the rights of the defrauded seller to rescind and to reclaim have been recognized in the absence of statute. Although section 2-702 may in effect modify the common law definition of fraud by allowing the seller to reclaim within 10 days even though there is not actual misrepresentation of solvency, it is clear that basically the reclamation right is derived from the common law.⁶² Since the reclamation right is derived from the common law, it would not appear to arise "solely by force of statute."

Although the above conclusion has the support of logic, there is some pre-amendment case law which casts doubts on its validity. Banker's liens and repairman's liens have been held to be statutory liens even though they have common law antecedents.⁶³ The courts in these cases, however, did not appear to recognize that common law antecedents existed or that their existence would be relevant.

A more difficult case to reconcile is *Elliott v. Bumb*,⁶⁴ where the Ninth Circuit Court of Appeals found that a floating lien on the assets of a debtor was in "conflict with the federal bankruptcy scheme" even though it was allowed by state law.⁶⁵ In *Elliott*, a credit agency was appointed as the agent of a retail market to sell checks and money orders that the market issued. The agency sold about \$3,000 of these checks and money orders but placed only part of the proceeds in a separate bank account for its principal. The remainder was commingled with the agency's other assets. Subsequently, an involuntary petition in bankruptcy was brought against the agent, and it was adjudged a bankrupt. Under the common law of California, where the transaction took place, the money in the separate bank account was held in trust for the principal. The trust would not cover the rest of the proceeds unless the market could trace them in the hands of the agent. This rule was changed by a California statute which imposed a trust on all the money collected by the agent whether or not it could be traced.

The court found that the market could take the \$2,000 in the bank account as beneficiary of a valid common law trust but that, since the market would take the commingled proceeds only as a creditor under

Lumber Co., 126 F.2d 731 (4th Cir. 1942) (laborer's lien on all of the employer's assets).

⁶² See 3 S. Williston, Sales § 632 (rev. ed. 1948).

⁶³ *Gordon v. Sullivan*, 188 F.2d 980 (D.C. Cir. 1951); *Goggin v. Bank of America Nat'l Trust & Sav. Ass'n*, 183 F.2d 322 (9th Cir. 1950).

⁶⁴ 356 F.2d 749 (9th Cir. 1966).

⁶⁵ *Id.* at 755. But cf. *In re Treister & Son, Inc.*, 145 F. Supp. 144 (S.D. N.Y. 1956); *In re Heintzelman Const. Co.*, 34 F. Supp. 109 (W.D. N.Y. 1940).

the common law, it could not take these proceeds as beneficiary under the California statute.⁶⁶ In reaching this conclusion, it found that the California statute attempted to set up a priority where none existed in the Bankruptcy Act and, therefore, that it was invalid in bankruptcy.

The similarity between the California statute in *Elliott* and section 2-702 is clear. As noted above, the common law allowed a seller to rescind a sale induced by a fraudulent misrepresentation of solvency by the buyer. Once the seller elected to rescind, the buyer would hold the property as a constructive trustee for the benefit of the seller,⁶⁷ just as the agent held the funds in the bank account for his principal. Section 2-702, like the California statute, is an attempt to increase the situations where a constructive trust will result.

It is here, however, that the similarity ends. In its statute, California has modified common law trust principles. The drafters of the Code, on the other hand, have modified the definition of fraud. Thus, where the California statute does not affect the right of the principal, but merely solidifies his remedy, the Code attempts to reinforce a common law right. This right-remedy distinction should dictate that section 2-702 should not be invalidated under *Elliott*. Statutory attempts to put creditors in a better position to enforce common law rights are clearly priorities since they increase the creditor's chance of enforcement when other creditors are involved. On the other hand, a statute that expands the scope of common law principles such as fraud affects the rights between the creditor and the debtor, and is not an attempt to set up a priority even though the remedy that is traditionally given with that right will put the creditor in a better position in relation to other creditors.

There may be a point, however, where even a statute that extends an existing right would be considered a state-created priority under *Elliott*. Thus, if California had defined the agent's retention of proceeds to be fraudulent as to the principal, it is doubtful that the court would let such action stand. Section 2-702 may transcend this boundary, since it allows the seller to reclaim even if he knew of the insolvency of the buyer when he shipped the goods.⁶⁸ It is almost inconceivable, however, that such a situation would ever arise.

The exact effect of the 1966 Bankruptcy Act amendments on these

⁶⁶ State law trusts are enforced in bankruptcy unless they depart from the general norm of trust law so much that they create, in effect, a state insolvency rule. In re Tate-Jones & Co., 85 F. Supp. 971 (W.D. Pa. 1949). See Comment, The No Property Rule in Federal Tax Lien Litigation, 24 Md. L. Rev. 310 (1964).

⁶⁷ Bogert § 471 at 6 (2d ed. 1960).

⁶⁸ See, Kennedy, *supra* note 44, at 552, 555; Note, Bankruptcy and Article Two of the Uniform Commercial Code, 79 Harv. L. Rev. 598, 611-12 (1966). A conclusive presumption of reliance on the debtor's insolvency might be applied here to circumvent situations such as these. Cf. Glenn § 343, at 597-98.

earlier statutory lien cases is unclear. In any event, the definition of statutory lien contained in section 1(29a) should not be applied any more strictly than the definition that can be extracted from the pre-amendment cases. As long as the courts recognize that the seller's right to reclaim does not arise solely by force of statute, the trustee should not be able to defeat the right in bankruptcy.⁶⁹

One additional point must be mentioned. The effect of finding that section 2-702 does not create a statutory lien would be a re-examination and a reversal of cases that held that bankers' liens and garagemen's liens were statutory liens. Even though these liens would not be invalid under Section 67c of the Bankruptcy Act,⁷⁰ this holding has important ramifications. Section 67 gives statutory liens immunity from a challenge under section 60,⁷¹ which invalidates preferences. A preference is defined as any transfer of a debtor's property to a creditor on account of an antecedent debt, made while the debtor is insolvent within four months of bankruptcy if the effect of the transfer is to enable the creditor to obtain a greater share of his debt than some other creditor. The right to reclaim can never be a preference since the seller's right accrues the minute the debt is created, and, thus, there is not an antecedent debt situation.⁷² A banker, on the other hand, may take a lien to secure an antecedent debt.⁷³ Similarly, a garageman may lose his lien by relinquishing possession of a vehicle and then regain his lien by regaining possession.⁷⁴ If either of these situations occur within four months of bankruptcy the lien may be invalidated under section 60.

Although this result would be a major change in the law, it is a change that is consistent with the policy of section 67. The immunity from section 60 is necessary to validate tax liens and mechanic's liens which are inchoate when they arise. Otherwise, these liens could never be valid if the debtor should go bankrupt within four months from the time that the value is given and the liens are created. The banker or the garageman, on the other hand, can avoid having the liens arise because

⁶⁹ There are also policy factors that may weigh in favor of the seller's right to reclaim. The section does not apply to a class of persons generally, that is, all sellers. Section 67b of the Bankruptcy Act, 11 U.S.C. § 107(b) (1964), treats statutory liens of classes of persons. It is possible that this limited treatment of statutory liens may also be applied in interpreting sections 1(29a), 11 U.S.C. § 1(29a) (Supp. II 1967), and 67c, 11 U.S.C. § 107(b) (1964).

Also, the seller's reclamation right applies only to the property transferred, whereas only floating liens, for the most part, have been invalidated. See H.R. Rep. No. 2320, 82d Cong., 2d Sess., 1952 U.S. Code Cong. & Ad. News 1960, 1973.

⁷⁰ 11 U.S.C. § 107(b) (1964).

⁷¹ 11 U.S.C. § 96 (1964).

⁷² *Manly v. Ohio Shoe Co.*, 25 F.2d 384, 385 (4th Cir. 1928); *Kennedy*, *supra* note 44, at 554-56; *Note*, *supra* note 68, at 612.

⁷³ See *Goggin v. Bank of America Nat'l Trust & Sav. Ass'n*, 183 F.2d 322 (9th Cir. 1950).

⁷⁴ See *Gordon v. Sullivan*, 188 F.2d 980 (D.C. Cir. 1951).

of an antecedent debt and should respond to a claim that he has received a voidable preference if he does not so avoid the liens.

III. RIGHTS OF A BUYER NOT HAVING POSSESSION

Under the Code, the buyer who does not have possession has available three possible theories under which he can establish a right to possession. Section 2-716(1) provides that the buyer may obtain specific performance of the contract and, thus, obtain the goods "where the goods are unique or in other proper circumstances."⁷⁵ Under section 2-716(3), the buyer may replevy the goods if they are identified to the contract and if the buyer cannot obtain substitute goods by reasonable efforts. Finally, under section 2-502, a buyer who has paid part or all of the purchase price to a seller who becomes insolvent within ten days after the first payment of the price can recover goods identified to the contract.

This section of the article will analyze the right of the buyer to obtain possession as against his seller and third party claimants: the buyer in the ordinary course of business, a good faith purchaser other than a buyer in the ordinary course, a lien creditor and the trustee in bankruptcy. The rights of the buyer against the seller will be analyzed under each of the theories presented above. The rights of the buyer against third party claimants will not be analyzed in terms of the theory on which the buyer is basing his claim for the goods. Generally, the rights against third parties are the same regardless of which theory is used. The right to specific performance, however, is not available against subsequent purchasers since the purchaser is not a party to the contract. Therefore, the discussion of subsequent purchasers is not relevant when the buyer is attempting to obtain the goods through specific performance.

A. *Rights Against the Seller*

The right to specific performance contained in section 2-716(1) was recognized at common law⁷⁶ and under the Uniform Sales Act.⁷⁷ The section was not intended to change the law to a significant degree or to inhibit its growth. It was intended, however, to foster a liberal attitude in the courts as to when specific performance shall be given.⁷⁸

The section 2-716(3) right to replevin overlaps the right to specific performance to a great extent. Section 2-716(3) requires that substitute goods cannot be obtained. This lack of substitute goods

⁷⁵ This subsection may also give the buyer the right to possession of goods in transit.

⁷⁶ See 5A A. Corbin, Contracts § 1146 (1964).

⁷⁷ U.S.A. § 68.

⁷⁸ U.C.C. § 2-716, Comment 1.

would also seem to make the goods "unique" so that specific performance would be available. Replevin is available, however, only when the goods have been identified to the contract, whereas specific performance is available even if there is no identification.

The section 2-502 right to recover the goods is available to the buyer only if the seller becomes insolvent within ten days after receipt of the first installment of the price. The section does not appear to apply to transactions in which the buyer makes an initial payment of all or part of the price after the seller becomes insolvent.⁷⁹ This reading may impose a hardship on the buyer, however. The Code contains three alternative definitions of insolvency in section 1-201(23): ceasing to pay debts as they become due in the ordinary course of business, inability to pay debts as they become due, or excess of debts over available assets.⁸⁰ It is unlikely that the buyer will know if the seller is insolvent under either of the last two definitions since the buyer has no way of valuing the seller's assets or liabilities. The buyer may, however, be able to determine whether the seller has ceased to pay his debts although even this determination may be difficult to make. If all three of the definitions apply to section 2-502, the buyer who pays part or all of the price after determining that the seller has not ceased to pay his debts may not be able to recover the goods because the seller's debts exceeded his assets at the time of payment. Yet this buyer has clearly been defrauded to the same extent as a buyer who pays the price before the seller is insolvent.

This inequitable situation can be remedied by interpretation of section 2-502 as encompassing only one of the three definitions of insolvency in section 1-201(23). That is, the definitions that involve inability to pay debts should be found to be inappropriate to section 2-502 since the buyer has no practical way of determining if the seller is unable to pay all of his debts.

With some slight straining of language it might be possible to give the buyer more protection. The burden of checking on whether the seller has ceased to pay his debts is probably too great for the buyer to bear. Therefore, if the phrase "becomes insolvent within ten days after receipt of the first installment" were interpreted to mean "becomes insolvent at any time prior to ten days after payment," the buyer would be relieved of the burden of showing that the seller had not ceased to pay his debts when payment was made. In addition to relieving the buyer of a difficult burden, this interpretation would also put his rights on an equal footing with the rights of the seller where the buyer is

⁷⁹ See Nordstrom, *supra* note 44, at 1178; Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two*, 73 *Yale L.J.* 199, 235 (1963); Note, *supra* note 68, at 601.

⁸⁰ The third definition of insolvency is that of the Bankruptcy Act § 1(19), 11 U.S.C. § 1(19) (1964).

insolvent. If the buyer is insolvent when the goods are delivered, the seller may reclaim under section 2-702 even if the buyer made no representation of solvency. There is no reason why this type of implied fraud rule should not be applied where the seller is insolvent.

B. *Rights Against a Buyer in the Ordinary Course*

Under section 2-403(2), any entrusting of possession of goods to a merchant who deals in goods of that kind gives him the power to transfer all rights in those goods to a buyer in the ordinary course of business.⁸¹ Entrusting in this context includes any acquiescence in possession.⁸² Since a buyer in the ordinary course of business must, by definition, take goods from a dealer of goods of that kind and since a buyer who is attempting to recover possession under sections 2-716 or 2-502 will always have acquiesced to possession in his seller, a third party buyer in the ordinary course will always cut off the rights of a prior buyer attempting to obtain possession of the goods.

Although it is clear that a buyer will lose to a subsequent buyer in the ordinary course of business, it is not clear when a subsequent buyer fits within the definition of buyer in the ordinary course of business contained in section 1-201(9):

"Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker

Section 25 of the Uniform Sales Act is similar to section 2-403(2). Section 25, however, required that the subsequent buyer obtain possession and pay value before he could defeat the interest of the original buyer.⁸³ Under the Code, it is clear that the subsequent buyer does not have to give value immediately to be a buyer in the ordinary course of business.⁸⁴ It is not clear, however, whether the subsequent buyer must obtain possession.⁸⁵ In fact, there is no statement in the Code that a buyer in the ordinary course of business must obtain title.

⁸¹ See U.C.C. § 1-201(9) for the definition of buyer in ordinary course of business.

⁸² U.C.C. § 2-403(3).

⁸³ See, e.g., *Coburn v. Drown*, 114 Vt. 158, 40 A.2d 528 (1945).

⁸⁴ This was also true under the Sales Act. See *Hewgley v. General Motors Acceptance Corp.*, 39 Tenn. App. 553, 286 S.W.2d 355 (1955). If the second buyer has not paid for the goods, the first buyer may still have some remedy. He can sue the seller and establish a trust interest in the unpaid purchase price. If the seller has received the price and has commingled it with his other monetary assets, the buyer can no longer do this. See *Bogert* § 476.

⁸⁵ See generally 1 New York Law Revision Commission Report, Study of the Uniform Commercial Code 232, 457 (1955).

Analysis of this ambiguity in the Code must begin with the definition of buyer in the ordinary course of business in section 1-201(9). Such a buyer is there defined in terms of a person who "buys in the ordinary course." Buying is then partially defined:

"Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale . . .

The use of the words "receiving goods" indicates that taking possession is a requisite to buying.

Defining buying in terms of possession, however, creates some difficulty in this context. The definition of buying in the ordinary course of business includes a requirement that there be a sale. Although sale is not defined in Article 1, it is defined in section 2-106(1):

(1) In this Article unless the context otherwise requires . . . "[c]ontract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (Section 2-401). A "present sale" means a sale which is accomplished by the making of the contract.

From this definition two conclusions can be drawn: (1) a sale is more than simply a contract for sale; (2) a passage of title is a necessary element of a sale. Since passage of title does not depend on passage of possession,⁸⁶ it may also be inferred that passage of possession is not a prerequisite to the existence of a sale. If a sale can be completed without the passage of possession, it would be ironic to find that one cannot buy without receiving possession.

There are two possible solutions to this apparent conflict. The Article 2 definition of sale may not be applicable in Article 1.⁸⁷ As a result, a sale for purposes of Article 1 may require passage of possession even though a sale under Article 2 does not.⁸⁸ A better alternative comes from an examination of the definition of buying. Section 1-201(9) states that "'buying' . . . includes receiving goods . . . under a pre-existing contract for sale. (Emphasis added.)" Since receiving goods under a pre-existing contract for sale is only an example of buying, the possibility that one can buy without taking possession is not excluded.

Neither of these alternatives is particularly convincing, and, for

⁸⁶ See U.C.C. § 2-401(2).

⁸⁷ See section 2-106(1), which begins "In this Article. . ."

⁸⁸ This, of course, may require some mental gymnastics when the definition of buyer in the ordinary course is used in section 2-403(2). If the definition of sale in Article 2 does not apply to Article 1, what happens to a term that is defined in Article 1 in terms of "sale" when it is applied in Article 2?

this reason, it is doubtful that analysis of the buyer in the ordinary course requirements should be attempted from the definitions of "buying" and "sale." It is more fruitful to look to the context within which the term buyer in the ordinary course is used and especially at the apparent purpose of the provisions. Subsection (2) of section 2-403 which provides for the rights of the buyer in the ordinary course of business talks of entrusting of possession of goods to a merchant. Subsection (1) of section 2-403, on the other hand, refers to title, voidable title and good faith purchasers.⁸⁹ Purchaser as defined in the Code includes anyone taking by sale and, therefore, anyone taking title.⁹⁰ It appears that subsection (1) and subsection (2) are meant to be distinguished. That is, where subsection (1) is concerned with title, subsection (2) is concerned with possession. In this context, therefore, the intent of the drafters would appear to be that a buyer is not a buyer in the ordinary course until he obtains possession.⁹¹

C. *Rights of the Buyer Against Other Good Faith Purchasers*

The relative rights of a buyer and a subsequent good faith purchaser other than a buyer in the ordinary course are difficult to discover. When the Uniform Sales Act was in force there were three possible theories under which the subsequent good faith purchaser could defeat the interest of the original buyer in the goods. Section 25 provided that the subsequent purchaser would defeat the rights of the original seller if the purchaser could show that he obtained possession and paid the purchase price in good faith. Under section 23, the subsequent purchaser may prevail if title is in the original buyer and the original buyer is, by his conduct, estopped from denying the seller's authority to sell.⁹² The third theory was based on fraudulent retention of possession by the seller. Under the common law of some states, retention of possession by the seller was presumed to be fraudulent.⁹³

⁸⁹ Subsection (1) is concerned with the power of a purchaser to transfer title to goods when he has received only voidable title.

⁹⁰ See U.C.C. §§ 1-201(32), -201(33).

⁹¹ This interpretation is supported by the wording of prior versions of the Code. In the 1950 draft of the Code, buyer in ordinary course of business was defined in section 2-403(4) as "a person to whom goods are shipped pursuant to a pre-existing contract or one to whom they are delivered on credit. . . ." Since the buyer in the ordinary course had to take delivery, he had to obtain possession. This interpretation is also consistent with the analogous situation of a secured party attempting to enforce against a buyer of the collateral. In that case the buyer will defeat an unperfected security interest but only if the buyer obtains possession. U.C.C. § 9-301(1)(c). Although the necessity of possession seems clear, one case may suggest that only title is important. Cf. *Main Inv. Co. v. Gisolfi*, 203 Pa. Super. 244, 199 A.2d 535 (1964).

⁹² The buyer must give the seller some indicia of ownership. Possession in the seller is not sufficient to set up an estoppel. See *Avis Rent-A-Car Sys. v. Woelfel*, 155 Colo. 207, 393 P.2d 551 (1964).

⁹³ See *Glenn* at § 354. But cf. *Coburn v. Downs*, 114 Vt. 158, 40 A.2d 528 (1945).

This principle remained in most states even though the Uniform Sales Act was in effect.⁹⁴

The Code continues the estoppel theory in section 2-403(2), but only when the buyer is a buyer in ordinary course. Otherwise, the fraudulent retention theory and the provisions of sections 23 and 25 of the Uniform Sales Act as they are relevant here are not expressly carried into the Code. Because of this ambiguity, a number of arguments can be made respecting the rights of the buyer against a subsequent good faith purchaser.⁹⁵

One possible method of attacking the problem is to look to sections 2-716 and 2-502, which define the rights of the buyer as against his seller. It can be argued that in the absence of provisions to the contrary, the rights of the buyer are contained solely in these sections. If this argument is accepted a number of conclusions can be drawn.

Section 2-502 provides that the buyer can recover the goods "from the seller" if the seller becomes insolvent within ten days after receipt of the first installment of the price. Since recovery only against the seller is mentioned, the buyer must have no rights against a subsequent buyer.

Section 2-716(3) provides for replevin, but it does not state who is subject to this right of replevin. Therefore, it would seem that the buyer could replevy the goods from any person who has possession of them.

Although these conclusions may have some merit, the chance of their acceptance is small in view of the weakness of the assumption behind them. There is no indication either in the sections or in the comments to the sections that they were intended to provide for the buyer's rights against anyone other than the seller. As a result, conclusions drawn on the presence of the words "from the seller" or the absence of mention of any person against whom the buyer can enforce seem to be invalid. Another possible approach is to form a rule depending solely on title in the buyer. Section 2-403(1) provides that a "person with voidable title has power to transfer a good title to a good faith purchaser for value." Since a person with voidable title can transfer good title, it would seem that a person with complete title can also do so. Thus it can be argued that as long as the seller has title he has the power to transfer good title to a good faith purchaser for value and defeat the interest of the buyer. When title is shifted to the buyer, however, the

⁹⁴ See Glenn at § 354.

⁹⁵ The problems associated with the estoppel and fraudulent retention of possession theories will not be discussed in the following analysis. It is assumed that if the second buyer can show that the original buyer is estopped, or that the retention of possession by the seller is fraudulent under the common law, the second buyer will win.

seller can no longer transfer title unless his retention of possession is fraudulent.⁹⁶

The effect of such a rule would be to afford negligible protection to the buyer since only in rare instances would the seller still have possession after title had shifted to the buyer. Thus for this reason, it is somewhat doubtful that section 2-403(1) was intended to cover this situation. For this reason, the leap from the "voidable title" language of the section to the perfect title of the seller, subject to his contractual obligations, should not be taken in spite of the logical simplicity of such a step.

An entirely different approach to the problem of the subsequent good faith purchaser is suggested by section 2-403(4): "The rights of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9). . . ." If this reference is applicable to the rights of subsequent purchasers against the original buyer, the original buyer must have a security interest in the goods.

It is somewhat difficult to say that the buyer's contract rights are, in actuality, a security interest. Where the goods are identified to the contract and the buyer has received a special property interest, however, the theory stands on firmer ground. It is possible to conceptualize this special property interest as an interest securing the seller's performance of his obligation. The property interest gives the buyer greater rights since he can obtain replevin under section 2-716, or recovery where the seller is insolvent under section 2-502 once the goods are identified to the contract. This is not to say that in all instances when the buyer obtains a special property interest he is a secured party. The rule could be limited to those instances where the special property interest is intended as security because the buyer has paid part or all of the price and the seller still has possession of the goods.

If the security interest approach were accepted,⁹⁷ the original buyer would lose his claim to the goods to a purchaser who gave value and obtained possession without knowledge of the original buyer's interest, unless he perfected his security interest.⁹⁸ Once the original buyer perfected, he would defeat the interest of the subsequent good faith purchaser.⁹⁹

Although the security interest approach is a logical solution to the problem of the subsequent good faith purchaser, it is of little more than historical significance. Section 9-204(6) originally provided that a

⁹⁶ Even if it is not fraudulent, a second buyer in ordinary course may win under § 2-403(2).

⁹⁷ The conceptual and practical problems associated with this interpretation are well set out in 1 New York Law Revision Commission Reports, Study of the Uniform Commercial Code 453-54 (1955).

⁹⁸ See U.C.C. § 9-301(1)(c).

⁹⁹ There is an exception to this rule for consumer goods and farm equipment. See U.C.C. § 9-307(2).

buyer who advanced money for the acquisition or production of goods obtained a security interest in the goods.¹⁰⁰ In 1958, this provision was dropped from the Code and the following language was added to the definition of security interest contained in section 1-201(37):

The special property interest of a buyer of goods on identification of such goods to a contract for sale under Section 2-401 is not a "security interest," but a buyer may also acquire a "security interest" by complying with Article 9.

In view of this language, it can no longer be argued that the buyer obtains a security interest when the goods become identified to the contract. It might be possible to argue that when the buyer obtains full title while the seller still has possession, the buyer obtains a security interest. This argument is of doubtful validity, however, since title gives the buyer no more rights against the seller than he has when he obtains only a special property interest.

There are no other sections of the Code that can be interpreted to apply to the problem of determining the buyer's rights against a subsequent good faith purchaser. There is, however, an analogous situation which the Code provides for that can be used in reaching a realistic solution. As noted above, under section 9-301(1)(c) an unperfected secured interest will be defeated by a buyer who gives value and takes possession without knowledge of the security interest. If the security interest is perfected, however, it will defeat the interest of such a buyer.

A situation similar to that provided for in section 9-301 is present here where the subsequent purchaser is not a secured party but a buyer. If the subsequent buyer does not have possession, he is like the holder of an unperfected security interest since third parties have no notice of his interest. If he obtains possession the result is the same as perfecting a security interest—he gives notice of his claim to third parties.

If the analogy were strictly followed, the original buyer would defeat the interest of subsequent good faith purchasers only if those purchasers had not obtained possession. Although this priority seems like the best solution to the problem of the subsequent good faith purchaser¹⁰¹ it does have deficiencies. It does not come from the express language of the Code, but, instead, must be built up by analogy. Also, the result is to provide the same rights to a good faith purchaser as to

¹⁰⁰ U.C.C. § 9-204(6) (1952 version).

¹⁰¹ There are other possible solutions that are not covered in the text because the probability of their acceptance is minimal. For example, section 2-722 gives the buyer a right of action against a third party who deals with the goods as to cause actionable injury to the buyer. Although the section on its face appears to open up possibilities, it has never been interpreted as giving substantive rights.

a buyer in the ordinary course even though the buyer in the ordinary course is singled out for protection in section 2-403(2).

D. *Rights of the Buyer Against Subsequent Lien Creditors*

The buyer's rights against the subsequent lien creditor are, for the most part, governed by section 2-402. Under subsection (2) of section 2-402, the buyer will defeat the interest of a subsequent creditor if four requirements are met: (1) there has been a sale or identification of the goods to the contract; (2) the seller is a merchant; (3) the retention of possession by the seller is in good faith and in the current course of trade; and (4) the retention is for a commercially reasonable time. If, however, the retention is fraudulent under state law and the buyer cannot meet the four requirements set out above the creditor will defeat the rights of the buyer. Also, under subsection (3), if the identification or delivery to the buyer is not made in the current course of trade but, instead, in satisfaction of or as security for a pre-existing claim, the creditor will defeat the buyer if the circumstances are such that the transaction would be fraudulent under state law.

Subsections (2) and (3) of section 2-402 refer to the rights of "creditors," but they do not state what kind of creditors fall within the subsections. At common law, a seller's creditor can prevail under a fraudulent retention of possession theory only if he attaches or levies before the buyer obtains possession.¹⁰² In absence of statements to the contrary in subsections (2) and (3), it is safe to assume that the common law requirement that the creditor levy or attach is carried on.

Subsection (1) of section 2-402 also deals with the rights of the buyer against subsequent creditors. It provides that, except as provided in subsections (2) and (3), rights of "unsecured creditors" are subject to buyer's rights under sections 2-502 and 2-716. It is unclear what is meant by the term "unsecured creditors" in this subsection. Since the term "creditor" is used in subsections (2) and (3), it is possible that a different type of creditor comes under subsection (1). If subsections (2) and (3) deal with the lien creditor, it can be argued that the "unsecured creditor" provided for in subsection (1) is not a lien creditor but only a general creditor.¹⁰³

It is doubtful, however, that such weight should be given to the word "unsecured." It is more likely that an "unsecured creditor" is simply a creditor who is not secured. Thus, under subsection (1) both the general and the lien creditor cannot defeat the section 2-502 and section 2-716 rights of the buyer.

¹⁰² Glenn at § 349.

¹⁰³ See Shanker, A Reply to the Proposed Amendment of UCC Section 2-702(3): Another View of Lien Creditor's Rights vs. Rights of a Seller to an Insolvent, 14 W. Res. L. Rev. 93, 109 (1962).

There is one more section that may be relevant to the buyer's rights against lien creditors. Section 2-403(4) provides that the "rights of other purchasers of goods and of lien creditors are governed by (Article 9). . . ." In view of the ambiguities in section 2-402, this section could be interpreted as providing the sole source of the rights of lien creditors. Section 2-402 would then be interpreted as dealing only with the rights of buyers against general creditors. It is doubtful, however, that this is a proper interpretation of section 2-403(4). Article 9 has no section that provides for the rights of lien creditors against buyers. The effect, then, would be to give lien creditors no rights against the buyer even though under section 2-402 general creditors would have rights if the retention of possession by the seller were fraudulent. It is more likely that section 2-403(4) is referring to the rights of "other purchasers," specifically secured parties, as against lien creditors.

If the foregoing analysis is accepted, then the rights of the seller can be capsulized simply. If the buyer can show that the four requirements of subsection (2) of section 2-402 are met, the buyer's claim to the goods is superior to that of lien creditors. If the requirements of subsection (2) are not met, but the retention of possession by the seller is not fraudulent under state common law, the buyer still has a superior claim to the goods if they are identified to the contract. If the subsection (2) requirements are not met and the retention of possession is fraudulent under state common law, however, the lien creditor will defeat the rights of the buyer.

E. *Rights of the Buyer Against the Trustee in Bankruptcy*

The trustee in bankruptcy has available four possible theories to defeat the rights of the buyer under sections 2-716 and 2-502: (1) the buyer's rights are subject to those of a lien creditor and, therefore, are subject to the claim of the trustee under the Bankruptcy Act, Sections 67d,¹⁰⁴ 70c¹⁰⁵ and 70e;¹⁰⁶ (2) the contract between the seller and the buyer is executory and, therefore, the trustee can reject it under Section 70b of the Bankruptcy Act;¹⁰⁷ (3) sections 2-502 and 2-716 are statutory liens invalid against the trustee under Section 67c of the Bankruptcy Act;¹⁰⁸ (4) the buyer's "special property interest" is a voidable preference under Bankruptcy Act Section 60.¹⁰⁹ This section will consider the applicability and strength of each of these theories.

Sections 67d¹¹⁰ and 70c¹¹¹ of the Bankruptcy Act deal with trans-

¹⁰⁴ 11 U.S.C. § 107(d) (1964).

¹⁰⁵ 11 U.S.C. § 110(c) (1964), as amended, (Supp. II 1966).

¹⁰⁶ 11 U.S.C. § 110(e) (1964).

¹⁰⁷ 11 U.S.C. § 110(b) (1964).

¹⁰⁸ 11 U.S.C. § 107(c) (1964), as amended, (Supp. II 1966).

¹⁰⁹ 11 U.S.C. § 96 (1964).

¹¹⁰ Section 67d(2)(d), 11 U.S.C. § 107(d)(2)(d) (1964), allows the trustee to set

fers that are fraudulent as to creditors. Section 70c gives the trustee the rights of a lien creditor at the time of bankruptcy.¹¹² In those instances where the buyer will defeat the rights of a lien creditor, it is clear that he will also defeat the claims of the trustee under sections 67d, 70c or 70e, since these sections give the trustee no greater rights than a lien creditor.¹¹³ Where the retention of possession by the seller is deemed fraudulent as to creditors, the trustee will defeat the interest of the buyer under these three sections.

The trustee's power to set aside executory contracts will be a substantial weapon against the buyer. Where the goods have not been identified to the contract there is no doubt that the contract is executory. Existing decisions appear to go even further. If the goods have been identified to the contract or if the buyer has paid all of the price, the trustee will probably be able to set aside the contract. In these situations the contract is still executory from the side of the seller and this is crucial.¹¹⁴

In situations where part of the price has been paid the result upon the buyer may be inequitable. Although it has been suggested that the trustee would have to return the buyer's down payment,¹¹⁵ the few decisions on point show that the buyer is treated as a general creditor regardless of whether he has advanced part of the price.¹¹⁶ In addition, the trustee will almost always want to set aside the contract where the buyer has paid part of the price. The trustee's role is to make as large a pool as possible for the general creditors. As a result, he will set aside executory contracts where the value which the bankrupt is obligated to give is worth more than the value the bankrupt will receive.¹¹⁷ Where the buyer advances the price, the value of the goods will almost always exceed the part of the price still due. Therefore, it is to the trustee's advantage to set aside the contract and retain the goods.

The trustee's argument that the buyer's rights are statutory liens

aside transfers made within one year of bankruptcy if these transfers were made with the intent to hinder, delay, or defraud existing creditors.

¹¹¹ Section 70e, 11 U.S.C. § 110(e) (1964), voids transfers that are fraudulent as against creditors.

¹¹² Under section 70c, 11 U.S.C. § 110(c) (1964), as amended, (Supp. II 1966), the trustee has the rights and powers of (1) a creditor who obtained a judgment on the date of bankruptcy, (2) a creditor who executed on the day of bankruptcy and (3) a creditor who obtained a lien on the date of bankruptcy.

¹¹³ Cf. *Moore v. Bay*, 284 U.S. 4 (1931).

¹¹⁴ Compare Silverstein, *Rejection of Executory Contracts in Bankruptcy and Reorganization*, 31 U. Chi. L. Rev. 467, 474-83 (1964) with Note, *supra* note 68, at 604.

¹¹⁵ Silverstein, *supra* note 114, at 475. Whether the trustee's rejection is viewed as a rescission or a rejection of burdensome property, it would seem equitable to require him to return the down payment.

¹¹⁶ See *Gulf Petroleum, S.A. v. Collazo*, 316 F.2d 257 (1st Cir. 1963). Cf. *Matter of New York Inv. Mut. Group, Inc.*, 143 F. Supp. 51 (S.D. N.Y. 1956).

¹¹⁷ See Note, *supra* note 68, at 604.

invalid in bankruptcy raises problems similar to those raised in relation to the seller's right to reclaim.¹¹⁸ Analysis of this argument must be directed at answering four questions: (1) Are the buyer's rights liens? (2) Are they statutory liens within the definition contained in Section 1(29a) of the Bankruptcy Act? (3) Do the buyer's rights first arise on the insolvency of the seller? (4) Can a bona fide purchaser defeat the buyer's rights on the day of bankruptcy? As discussed earlier, in order to prevail, the trustee must show that the first two questions can be answered in the affirmative and that one of the last two can also be answered in the affirmative.

There is no doubt that the first requirement is met; sections 2-716 and 2-502 give the buyer a lien.¹¹⁹ The fourth requirement creates more difficulty. As discussed above, it is not clear whether a subsequent bona fide purchaser can defeat the rights of the buyer under sections 2-716 and 2-502. A subsequent buyer in the ordinary course will defeat the rights of the buyer. Although the buyer in the ordinary course may be viewed as a type of bona fide purchaser, this fact should not be determinative. Section 67c refers only to a bona fide purchaser. In comparison, other sections of the Bankruptcy Act use the term buyer in the ordinary course when rights against such a buyer are important.¹²⁰ As a result, the absence of specific mention of the buyer in the ordinary course in section 67c should be interpreted to mean that a bona fide purchaser other than a buyer in the ordinary course must be able to defeat the buyer.

Whether the third requirement is met depends upon which theory the buyer is proceeding. Clearly neither the section 2-716(1) right to specific performance nor the section 2-716(3) right to reclaim first arise on the insolvency of the seller. On the other hand the buyer's right to recover under section 2-502 does arise when the seller becomes insolvent. Again, however, the fact that the Code contains three definitions of insolvency and the Bankruptcy Act contains only one becomes important. It is possible that the buyer's rights under section 2-502 may arise on the insolvency of the seller, but not in the bankruptcy sense. For example, the buyer's right may arise when the seller ceases to pay his debts as they become due in the ordinary course of business even though the seller's financial condition is not such that it meets the Bankruptcy Act test of debts exceeding assets. In such a case, the buyer's right to recover does not arise on the insolvency of the debtor as required by section 67c.¹²¹ It was suggested above that the test of

¹¹⁸ See p. 52 *supra*, where Sections 67c and 1(29a) of the Bankruptcy Act are quoted and discussed.

¹¹⁹ It could be argued that instead of a lien the buyer receives a limited title interest, but this argument has little chance of success.

¹²⁰ See, e.g., section 60a(6), 11 U.S.C. § 96(a)(6) (1964).

¹²¹ See p. 52 *supra*.

ceasing to pay debts as they became due is the only one appropriate for section 2-502. It was also suggested above that section 2-502 can be interpreted as giving a buyer the right to recover if he advances the price after the insolvency of the seller. If either of these interpretations were accepted, the buyer's right to recover cannot be deemed to arise on the insolvency of the seller.

Since the third and fourth requirements present alternatives, it is necessary to summarize to determine the trustee's chance of meeting one of the buyer's theories. The trustee may be able to show that a subsequent good faith purchaser can defeat the buyer's rights under sections 2-716 and 2-502. As discussed above, the trustee must argue by analogy and, in view of the possible alternatives, one can only speculate on the outcome. If the buyer is claiming under section 2-502, the trustee has a strong alternative claim that the buyer's right arises on the seller's insolvency. The chance of success here depends on whether the trustee's claim is stronger if the buyer is attempting to recover under section 2-502 and whether a court could go either way on the questions involved regardless of the theory under which the buyer proceeded.

The second requirement, that the buyer's rights arise solely by force of statute, creates problems for the trustee. Since the section 2-716(3) right to replevin and the section 2-502 right to recovery on the seller's insolvency have common law antecedents, it is necessary to analyze these antecedents to determine how much of a change has been effected by the Code.

At common law, the buyer could recover the goods from the seller if the buyer had "property" in the goods, a concept not meaningfully distinguishable from title, as the term is now used in the Code.¹²² Under the Sales Act, the buyer's rights similarly depended on his having "property" in the goods.¹²³ This property was acquired by the buyer when the seller appropriated the goods to the contract with the assent of the buyer.¹²⁴

When the Code is placed in context with the common law and the Sales Act a progression can be seen. The Code limits the buyer's ability to recover the goods to two specific instances: (1) replevin where cover cannot be obtained and (2) recovery where the seller is insolvent. On the other hand, the Code extends the availability of these rights to situations where only identification is present. This extension does not produce results much different from those under the Sales Act since the special property interest received on identification under the Code is

¹²² See 3 W. Holdsworth, *A History of English Law* 351-60 (5th ed. 1942). "Property" in goods originally meant only a superior right to possession, but grew to mean ownership or title.

¹²³ U.S.A. §§ 66, 67.

¹²⁴ U.S.A. § 18.

not greatly different from the "property" under the Sales Act. The Code and the Sales Act represent significant steps beyond the common law, however, since identification may occur long before title is passed.¹²⁵

The trustee's burden under section 67 must be to show that the extension of previous rights by sections 2-716(3) and 2-502 is so great that the Code rights are, in effect, new rights. This is the same burden that he had in showing that the seller's right to reclaim is a statutory lien. Here, however, the trustee should have more success. The words used in section 67 are "solely by force of statute." Therefore, the Code must be compared to the common law, not the Sales Act when they are evaluated under this test.

The rights of the buyer under the Code are wholly different from those under the common law. Where replevin was a right based on title, title is no longer relevant. Also, common law replevin is a right available whenever the buyer has title. The buyer's rights under sections 2-716(3) and 2-502 are limited to specific situations. In summary, the Code's rights are better typed as rights created by statute, not extensions of rights created by common law.

There are two reasons, however, why the trustee's position is not as strong as it appears above. First, Sales Act replevin actions have been held to be allowable against the trustee in bankruptcy.¹²⁶ Since the replevin under the Sales Act is not vastly different from replevin or recovery under the Code, these decisions appear to support the validity of the buyer's claim against the trustee.

The second reason is that the policy of the Bankruptcy Act seems more consistent with upholding the right to replevin or recovery upon insolvency against the trustee. The definition of statutory lien contained in Section 1(29a) of the Bankruptcy Act specifically excludes security interests whether or not such security interests arise as a result of statutory provisions. Thus, it was not intended that all liens that are derived from statutes should be invalidated even though these liens may arise on the insolvency of the debtor or be subject to defeasance by a bona fide purchaser.¹²⁷

The buyer's "special property interest" that is the requisite of a right of recovery is very much like a security interest. It is created by the making of the contract of sale and the identification of the goods to the contract. This process is analogous to that involved in the creation of a security interest: the making of a security agreement and the debtor's acquiring rights in the collateral. From the "special property

¹²⁵ See U.C.C. § 2-501 for the rules that dictate when identification occurs.

¹²⁶ See *In re American Boiler Works, Inc.*, 220 F.2d 319 (3d Cir. 1955); *In re Shipley Stave & Lumber Co.*, 29 F. Supp. 746 (E.D. Ky. 1939).

¹²⁷ Under Article 9, a security interest may be perfected against lien creditors but not against a buyer in the ordinary course of business, U.C.C. § 9-307(1), or a buyer "for his own personal, family or household purposes. . . ." U.C.C. § 9-307(2).

interest" the buyer acquires the right to obtain possession of the goods in certain instances. Similarly, a security interest gives the secured party a right to the collateral for satisfaction of an underlying debt. If the Bankruptcy Act recognizes the validity of the security interest in bankruptcy, it should also recognize the existence of the buyer's "special property interest" and the rights that flow from it. One does not subvert the purposes of the Bankruptcy Act any more than the other.

In view of the above objectives of allowing the trustee to use the statutory lien provisions of the Bankruptcy Act to defeat the buyer's attempt to recover the goods, it is doubtful that the trustee should prevail. In addition, even if a court were to ignore the countervailing policy considerations, it would be difficult for it to find that the trustee has shown that the buyer's rights fall within one of the two alternative tests: (1) that they can be defeated by a bona fide purchaser or (2) that they arise on the insolvency of the seller. Therefore, it would seem that section 67(c) provides no bar to the buyer's recovering the goods from the trustee.

The trustee's rights under Section 60b of the Bankruptcy Act¹²⁸ to set aside preferential transfers presents in certain situations a more formidable obstacle for the buyer who is attempting to recover the goods. A preference is defined in section 60a(1) as a transfer of property (1) from the debtor to the creditor; (2) for or on account of an antecedent debt; (3) made while the debtor was insolvent; (4) within four months of bankruptcy if (5) the effect of the transfer is to give the creditor a greater percentage of his debt than other creditors of the same class. (The numbers are added to separate the requirements and to simplify the discussions.) In regard to personal property, section 60a(2) defines "transfer" as used in section 60a(1) as taking place at the time when the property interest in the transferee becomes so far perfected that it cannot be defeated by a contract lien, either equitable or legal. The term "perfection" in section 60a(2) is limited by the provision in section 60a(6) that a transfer which creates an equitable lien in certain situations can never be "perfected" even if it is valid against a lien creditor. Under section 60b, the trustee may set aside a preference if the creditor receiving it had reasonable cause to believe the debtor was insolvent at the time of the transfer.

Some of the above requirements of a preference will determine whether the buyer's right to replevin and recovery on insolvency can ever be preferential transfers, whereas others only determine under what circumstances those rights are preferences. This discussion will first treat the former requirements and then, assuming it is determined

¹²⁸ 11 U.S.C. § 96(b) (1964).

that the trustee can ever defeat the buyer, the discussion will go on to the latter requirements to determine the scope of the trustee's power. The requirements in the first category are: (1) there must be a debtor-creditor relationship; (2) there must be an antecedent debt; (3) the effect of the transfer must be to give to the creditor a greater percentage of his debt than other creditors of the same class.

Before discussion of these requirements, it is necessary to set the stage. A preference is a transfer of property. In the case of the buyer's right to replevin or recovery on the insolvency of the debtor, the property is the special property interest which the buyer receives upon identification of the goods to the contract, for that is the property interest upon which the buyer's rights are based. In the normal situation, the transfer, if it occurs at all, occurs upon identification, not only because the property interest arises at that time, but also because that is the time at which the section 60a(2) requirement that the property interest be perfected against a lien creditor is met.¹²⁹ If section 60 applies at all to the buyer's rights, it will be within this framework.

The first requirement, that a debtor-creditor relationship exist, raises considerable difficulty because those terms are in no way defined. There have been two decisions, one involving the common law¹³⁰ and the other the Sales Act,¹³¹ on the question of whether the relationship between the buyer attempting to recover the goods and his seller is that of creditor and debtor. In both, it was held that the relationship was that of a vendor and vendee and, therefore, that the statute did not apply.

There must be some doubt as to the correctness of these decisions, however. There is certainly no clear-cut line between a vendor-vendee relationship and a debtor-creditor relationship. In fact, they appear to be wholly different generic classifications. When a seller delivers goods to a buyer, the buyer becomes obligated to pay the price. The fact that the buyer is a vendee does not mean that he is not a debtor, nor is the vendor any less a creditor. It would seem, therefore, that the reasoning of the two cases is faulty.¹³² In the case of the buyer's right to replevin or recovery on the insolvency of the seller, the mere fact that the buyer has a lien to secure receipt of the goods makes him a creditor and the seller a debtor.

The second requirement, that the transfer be on behalf of an antecedent debt, also raises substantial problems of interpretation. Two types of situations may arise which will create different problems. The

¹²⁹ U.C.C. § 2-502(2).

¹³⁰ *Templeton v. Kehler*, 173 F. 575 (E.D. Pa. 1909).

¹³¹ *In re Shipley Stave & Lumber Co.*, 29 F. Supp. 746, 749 (E.D. Ky. 1939).

¹³² See *Hurley v. Atchison, T. & S.F. Ry.*, 213 U.S. 126 (1909), cited as authority in *In re Shipley Stave and Lumber Co.*, 29 F. Supp. 746, 749 (E.D. Ky. 1939). It is difficult to see how this case stands for that proposition at all. For a proper application of *Hurley* see *Gage Lumber Co. v. McEldowney*, 207 F. 255 (6th Cir. 1913).

first occurs where the goods are in existence at the time of the making of the contract and identification occurs immediately. The second arises where identification does not occur at the time of the making of the contract. In the first instance, it would seem that since the transfer occurs at the time of the making of the contract there can be no antecedent debt. All relevant events happen simultaneously.

Although this conclusion is no doubt accurate, it is subject to one objection that must be considered. Although transfer, as defined in section 60a(2), occurs when the creditor's interest becomes perfected against a lien creditor, there is an exception to this rule in certain situations where an equitable lien is involved. Therefore, the holder of an equitable lien has often had no transfer at all. Allowing him to enforce his interest, however, would complete the transfer and this would be a preference. Thus, the holder of an equitable lien, if he comes within section 60a(6), cannot assert his claim against the trustee.

Since the term "equitable lien" is largely undefined¹³³ it is possible that the buyer's rights could be placed in this category.¹³⁴ This view will not defeat the buyer's rights, however, because of the additional requirements of section 60a(6). The section strikes down such liens only where means of perfecting a legal lien are available. Whatever the interest of a buyer is termed, he has no method of further perfection other than obtaining possession. His ability to obtain possession is not in reality a means of further perfection since his lien is securing the receipt of possession.¹³⁵ Thus section 60a(6) cannot apply in this instance.

The second situation, where the buyer obtains his "special property interest" after contract formation presents greater problems. If the "debt" arises at the time of the contract, the transfer which occurs on identification is on account of an antecedent debt. If the debt arises at the time of the transfer, there is, of course, no antecedent debt situation. The former conclusion is more likely. All consensual elements have taken place and the seller has assumed the obligation to deliver the goods. The "transfer" merely secures that obligation.

¹³³ See *Caldwell v. Armstrong*, 342 F.2d 485, 490 (10th Cir. 1965), for an attempt at a definition. See also Countryman, *The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act*, 16 *Law & Contemp. Prob.* 76, 96-98 (1951), for a discussion of possible equitable liens under Article 9. The author has been unable to find any cases in which a right given directly by statute was called an equitable lien.

¹³⁴ Kennedy has come the closest in calling it a security interest perfected without filing. See *Kennedy*, *supra* note 44, at 557-58.

¹³⁵ See *Porter v. Searle*, 228 F.2d 748 (10th Cir. 1955); *United Pac. Ins. Co. v. First Nat'l Bank*, 222 F. Supp. 243 (D. Ore. 1963); *Cumberland Portland Cement Co. v. Reconstruction Fin. Corp.*, 140 F. Supp. 739 (E.D. Tenn. 1953), *aff'd*, 232 F.2d 930 (6th Cir. 1956); *Danai v. De Matteo Constr. Co.*, 102 F. Supp. 874 (D.N.H. 1952). See also *Caldwell v. Armstrong*, 342 F.2d 485 (10th Cir. 1965); Note, 69 *Harv. L. Rev.* 1492 (1956).

The last requirement, the increase in the creditor's share, is fulfilled and needs little explanation. Without the right to recover the goods the buyer is, at best, a general creditor.

In view of the above discussion, it would appear that the trustee may in some circumstances defeat the buyer as long as identification occurs subsequent to the formation of the contract for sale. Of course, the utility of the argument for the trustee depends on his establishing the following circumstances: (1) the transfer occurred within four months of bankruptcy; (2) the debtor was insolvent at the time of the transfer; and (3) the creditor knew of the debtor's insolvency at the time of the transfer. In the normal transaction, the trustee will be able to establish the existence of the first two requirements, but only on rare occasions would he be likely to establish the existence of the latter requirement. Since the transfer occurs on identification, identification will probably occur before the buyer learns of the seller's insolvency. Even if the buyer learns of the seller's insolvency before the date of identification, it will be a difficult fact for the trustee to prove. Because of this difficulty it is unlikely that trustees will find section 60 an effective weapon.

IV. THE RIGHT TO GOODS IN TRANSIT

A. *Seller*

The right of a seller, who has put goods in the hands of a carrier for delivery to the buyer, to regain possession of those goods is set out explicitly in sections 2-702 and 2-705 of the Code. Generally, the seller may stop delivery where (1) he discovers that the buyer is insolvent, (2) the buyer repudiates or fails to make payment or (3) the seller has a right to withhold or reclaim the goods.¹³⁶

These rights are not absolute, however. Not only must the goods still be in the possession of the carrier when the seller attempts to regain possession, but also the buyer must not have received notification from a bailee that he holds the goods. In addition, specific provisions for notice to the carrier are set out in section 2-705. Sections 2-702 and 2-705 relate only to the rights of the seller against the carrier. Once the goods get into the hands of the buyer, the seller must derive his rights from other sections.

B. *Buyer*

The buyer's right to obtain possession of goods held by a carrier falls within the general provisions regarding the buyer's right to replevin. Specifically, section 2-716 provides that the buyer has a right to replevin where "the goods have been shipped under reservation, and

¹³⁶ The Uniform Sales Act contained similar provisions. See U.S.A. §§ 53, 54.

satisfaction of the security interest in them has been made or tendered." From this language it can be inferred that replevin is the proper remedy where the seller does not hold a security interest in the goods and the interest to be acquired by the buyer is absolute.

As discussed above, at common law, the right to replevin was dependent upon title. This requirement is not present in the Code. In its place, the Code requires that the buyer have a special property interest that comes with identification of the goods to the contract. Since in the normal sales transaction, identification occurs before the seller puts the goods in the hands of the carrier, the buyer will almost always have the right to replevin the goods from the carrier.

Because the buyer's right to replevin is so expansive, there is a great possibility that it will come in conflict with the seller's right to stop the goods in transit. There is no doubt that if the seller is rightfully attempting to acquire the goods pursuant to section 2-705, he will prevail since his claim is enforceable against the buyer. On the other hand, if the seller is wrongfully attempting to regain possession, he cannot prevail.

The problem becomes more complex, however, when the seller wrongfully stops the goods in transit and diverts them to another buyer or to a lien creditor. The rights of the buyer in this situation are identical to those discussed above where the seller has never put the goods in the hands of the carrier and no further discussion is needed here.¹³⁷

CONCLUSION

The foregoing discussion has attempted to treat the right of each of the parties in a sales transaction to obtain possession of the goods when they are in the hands either of the other party to the sale, or of a carrier. In spite of the proclamations of the drafters of the Code to the contrary, it is clear that some areas must be filled in with common law principles and concepts.¹³⁸ It is also apparent that the use of title to determine rights and remedies is not dead. In some situations, such as those covered by section 2-403(1), the Code makes title controlling. In the many other situations where the Code provides no solutions, the courts will, in most cases, fall back on title to fashion a solution.¹³⁹

¹³⁷ For a statement of the prior law see *Adkins v. Damron*, 324 S.W.2d 489 (Ky. 1959).

¹³⁸ See Vold, *Construing the Uniform Commercial Code: Its Own Twin Keys: Uniformity and Growth*, 50 Cornell L.Q. 49, 62 (1964).

¹³⁹ For lack of any other method, the conclusions with regard to title are often based on negative inference. It is felt, however, that such inferences are proper in the particular circumstances in which they are used. See, e.g., Skilton, *Some Comments on the Comments to the Uniform Commercial Code*, 1966 Wis. L. Rev. 597, 619.